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March 28, 2001

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, MA 02110

RE: Colonial Gas Company, D.T.E. 00-73

Dear Ms. Cottrell:

Consistent with the procedural schedule established in the above-referenced proceeding, Colonial Gas Company d/b/a KeySpan Energy Delivery New England ("Colonial" or the "Company") hereby responds to the Reply Brief of the Attorney General, which was filed on March 21, 2001. As discussed herein, the record in this proceeding demonstrates that the Company should be allowed recovery of lost-base revenues ("LBRs") in the amount of $1,267,722 for the period May 1999 through April 2000. Moreover, the record shows that the Attorney General's assertions that LBR recovery was accounted for in the merger proceeding (Eastern-Colonial Acquisition, D.T.E. 98-128 (1999) (the "Merger Order")) and that a "negative" cost adjustment is warranted as a result of the unbundling of Colonial's rates are incorrect and unfounded. Accordingly, the Department of Telecommunications and Energy (the "Department") should grant the Company's request to allow recovery of LBRs in the amount of $1,267,722.

First, in support of his claim that any recovery for LBRs now would be a "double collection," the Attorney General asserts that LBRs "were considered and given specific treatment by the Department in determining the cast-off revenue requirement and resulting merger savings" (Attorney General Reply Brief at 2). For the Attorney General's assertion regarding LBR recovery to be true, however, the Department would have had to have changed the Company's rates in the merger proceeding to account for the Company's LBRs. Yet, none of the Company's base rates was changed in that proceeding. This fact was emphasized by the Department in evaluating Colonial's stand-alone cost of service: "the Department notes that this is not a rate case proceeding where base rates are being established." Merger Order at 34.

The Attorney General acknowledges that the revenue-requirement analysis submitted in the merger case was used to measure: (1) the savings resulting from the ten-

year rate freeze; and (2) Colonial's cost-of-service in the absence of the merger (Attorney General Reply Brief at 2). The Attorney General is correct that, in the Merger Order, the Department reviewed "each component" of Colonial's proposed cost of service in order to determine what its cost of service would have been in the absence of the merger.[1] See Merger Order at 21-53. The Department's review and establishment of Colonial's stand-alone cost of service, however, was accomplished by determining the cost structure for the Company on a stand-alone basis without consideration of test-year revenues or revenue adjustments.

As explained in the Company's Initial Brief in this proceeding, the Company identified what its test-year revenues would have been if reduced by the amount of LBRs that had been collected in that year through the Local Distribution Adjustment Charge ("LDAC"). The Company made this adjustment to determine what the Company's revenue deficiency would have been in the absence of the merger in order to compute the customer benefits resulting from a base rate freeze. This calculation included adjustments to test-year revenues consistent with Department ratemaking precedent. These pro forma adjustments would have been made in a base-rate proceeding, and because the purpose of the exercise was to estimate the revenue deficiency that would have resulted from a base-rate proceeding in the absence of the merger, the Company appropriately made such an adjustment to the analysis. This analysis, however, did not result in an increase in the Company's base rates to account for LBRs.

The Company continues to collect LBRs through the LDAC, as it had in the test year, and the Department's change in LBR policy will deprive the Company of the ability to recover LBRs in the amount of $717,135, which constitutes an exogenous cost under the terms of the Department's approval of the rate freeze. Merger Order at 55.

Second, there is no basis for the Attorney General's claim that Colonial's rates should be reduced to account for a change in bad-debt expense that resulted from the Company's rate unbundling proceeding. As set forth in the Company's Initial Brief, the Attorney General's reasoning is flawed in two respects: (1) base rates were reduced in the rate unbundling proceeding because the bad-debt expense associated with gas costs are now collected through the Cost of Gas Adjustment clause (see Explanatory Statement at 3, Colonial Gas Company, D.T.E. 98-64);[2] and (2) the rate unbundling proceeding was concluded prior to the initiation of the base-rate freeze. Accordingly, the Attorney General's claim that rates should be reduced to account for this change must be rejected.

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[1] The stand-alone cost of service approved by the Department will later be compared to Colonial's post-merger cost of service following the expiration of the ten-year rate freeze to determine the savings resulting from the merger. Merger Order at 21.

[2] The record in D.T.E. 98-64 was incorporated by reference in this proceeding (Tr. 38-39).

With respect to the Company's burden in this proceeding, the Company has demonstrated that its request for recovery of LBRs in the amount of $717,135 for demand-side management measures installed during the period May 1992 through April 1996 meets the Department's standard for the recovery of exogenous costs under the terms of the Rate Plan approved by the Department in D.T.E. 98-128. Under those terms, the Company must demonstrate: (1) that the cost change is of a type that is external to the Company and is "beyond the company's control"; and (2) that the magnitude of the cost change would significantly affect the Company's operations, as determined by the threshold established by the Department for the Company. Merger Order at 55.

In the merger case, the Company requested that the Department make a finding that a change in its LBR policy would be encompassed under the definition of those types of costs that qualify for exogenous cost recovery. The Department specifically determined that such treatment was appropriate. Id. In addition, the Company has demonstrated that the LBRs proposed for recovery exceed the threshold of $250,000 established by the Department, and therefore, would significantly affect the operations of the Company.[3] Accordingly, the Company has demonstrated that LBRs in the amount of $717,135 are exogenous costs pursuant to the rate plan approved by the Department in D.T.E. 98-128.

The record in this proceeding also shows that the Company has correctly calculated LBRs using the Department's rolling-period methodology for demand-side measures installed during the period May 1996 through April 2000, which total $550,587. Therefore, for the reasons stated above and in the Company's Initial Brief, the Department should grant the Company's request to recover LBRs totaling $1,267,722 for the period May 1999 through April 2000.

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[3] The record also shows that the Department's traditional policy on the recovery of LBR allowed a company to recover LBRs if it could demonstrate that the "successful performance of its [conservation] programs will result in sales erosion that adversely affects revenues in a significant, quantifiable way." Colonial Gas Company, D.P.U. 91-150, at 69 (1992). Consistent with this finding, the Department approved several subsequent requests by the Company to recover LBRs following the implementation of its conservation programs in 1992. In this proceeding, the record shows that the Company's actual return on equity since the merger (exclusive of the amortized acquisition premium) was 9.76 percent in 1998, 5.21 percent in 1999 and 2.78 percent (projected) in 2000 (RR-DTE-2). The record also shows that loss of the LBRs proposed for recovery ($717,135) would double the Company's net-earnings loss in 2000 (id.).

Sincerely,

Cheryl M. Kimball

cc: Marcella Hickey, Hearing Officer
George Yiankos, Director, Gas Division
Richard A. Visconti, General Counsel, KeySpan Energy Delivery
Service List, D.T.E. 00-73